

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE**
45 Fremont Street
San Francisco, CA 94105

RH03029826

June 2, 2006

**Title 10
Proposed Revisions to Sections 2632.5, 2632.8 and 2632.11
Optional Automobile Insurance Rating Factors**

Summary and Response to Volume 6 Comments Received During 45-day Comment
Period

Responses to Common Comments:

1.1: Common Comments:

- Rates should be cost-based / substantially related to the risk of loss
- A driver's location (zip code) should be a critical factor in calculating insurance rates
- Drivers in rural regions of the state should not be forced to subsidize the rates for drivers in urban regions of the state.
- The proposed regulations will result in arbitrary rates because of the act of pumping and tempering, the resulting cross-subsidies, etc.

Response:

The Commissioner's regulations continue to permit a driver's location to be an important factor in setting insurance rates. While the proposed regulations preserve the importance of location in setting insurance rates, however, Proposition 103 provides that the factors which determine a driver's rates should be weighted in a specific order of importance. The proposed regulations will implement the weight ordering requirement of Proposition 103, which is codified in Insurance Code section 1861.02(a). The ballot pamphlet to Proposition 103 promised, in part, that "103 forces insurance companies to base your rates on your driving record first, rather than on where you live. That means good drivers throughout the state will pay less than they do now, while bad drivers will pay more." The ballot pamphlet also establishes that "In general, the measure requires that rates and premiums for automobile insurance be determined on the basis of the insured person's driving record, miles driven and number of years of driving experience." Finally, in the clearest possible terms, section 1 of Proposition 103 declares under the heading "Findings and Declaration" that "automobile insurance rates shall be determined primarily by a driver's safety record and mileage driven." To the extent that the cost of insurance may increase for some low income drivers and may affect businesses in rural or urban parts of the state, the increase will be determined primarily by the driver's safety record, mileage driven and years of driving experience, as Proposition 103 intended.

While some commentators believe that territory is the most important characteristic for determining the likelihood of an accident, there are other equally important, if not more important considerations which insurers often neglect under the existing regulations. Driving safety record, for example, is a very strong predictor of the risk of loss for an accident. Similarly, annual mileage driven bears a strong correlation to the risk of loss for an accident. The Department commonly observes instances where insurers do not collect meaningful data regarding the correlation between some of the mandatory factors and the risk of loss. One rating factor where insurer data is lacking is the mandatory factor of annual mileage driven. By way of example, the Commissioner has observed that one insurer arbitrarily places insurers into one of merely two categories: drivers that drive less than 7,500 miles per year and drivers who drive more than 7,500 drivers per year. Other examples show similar neglect for data collection regarding the mandatory factors. The existing regulations do not encourage insurers to develop better data collection for the mandatory rating factors, because they allow insurers to fall back on the crutch of territory for auto rating. The proposed regulations will stimulate insurers to conduct better data collection for mileage and driving safety record. This, in turn, will enhance the relationship to the risk of loss between those rating factors and the rates developed under the proposed regulations.

This comment contends that unlike the existing regulations, the proposed regulations will not be cost based and/or substantially related to the risk of loss.

The Court in *Spanish Speaking Citizens' Foundation v. Low* concluded that the language in Insurance Code section 1861.02(a)(4) which requires optional factors to be "substantially related to the risk of loss" also requires that the mandatory factors, and their order of importance must be substantially related to the risk of loss. The Commissioner notes, however, that Insurance Code section 1861.02(a)(4) expressly makes reference to the optional factors alone. Indeed, the Commissioner believes that Proposition 103 sought to bring fairness to automobile insurance rates, in part, by requiring the mandatory factors of driving safety record, annual miles driven and years of driving experience to assume greater weight than the optional factors irrespective of the mandatory factors' relationship to the risk of loss. While the Commissioner disagrees with the Court's interpretation of Insurance Code section 1861.02(a)(4) and the meaning of "substantially related to the risk of loss", the Commissioner recognizes that the *Spanish Speaking* decision represents the current state of the law, and his response takes into account the Court's interpretation in *Spanish Speaking*.

Notwithstanding the Commissioner's interpretation of Insurance Code section 1861.02(a)(4), the *Spanish Speaking* Court determined that for purposes of the weight ordering mandate, "interpretations that preserve a substantial relationship between premiums and the risk of loss ... are [] to be favored over those that would produce arbitrary rates." (*Spanish Speaking Citizens' Foundation v. Low* (2000) 85 Cal.App.4th 1179, 1227.) The commentator contends that the existing regulations are substantially related to the risk of loss, but that the proposed regulations are not and therefore are invalid. The fundamental assumption here is that the present rate regulations ensure cost-based rating. This assumption is demonstrably incorrect.

First, Proposition 103 as well as other laws reflect the voters' and Legislature's intent that public policy objectives must often prevail over considerations of cost-based pricing. For example, many insurers contend that a policyholder's lack of a history of prior insurance bears a strong correlation to the risk of an automobile accident. Despite insurers' preference for using the absence of prior insurance as a rating factor, Insurance Code section 1861.02(c) prohibits its use. (See, e.g., *Foundation for Taxpayer and Consumer Rights, et al. v. Garamendi* (2005) 132 Cal. App. 4th 1354.) Other examples of laws which require public policy to take precedence over an argument of cost-based pricing abound. (See, e.g. Ins. Code section 11628 & 679.71 [sex, race, color, religion, national origin, or ancestry cannot by itself constitute a risk for which a higher rate may be charged].) Directly at issue, Insurance Code section 1861.02 requires that automobile rates be determined by applying "in decreasing order of importance" the mandatory factors of driving safety record, annual mileage driven and years of driving experience, followed by any optional factors adopted by the Commissioner. Thus, concerns about cost-based pricing and the relationship to risk of loss often must yield to greater concerns of public policy, as reflected in the weight ordering requirements mandated by section 1861.02(a).

Moreover, the Department has observed numerous examples of rates which are not cost-based under the existing regulations, both within the course of this rulemaking proceeding as well as during its review of rate filings submitted to the Department. The Department's Rate Filing Branch commonly receives rate filings from insurers under the current regulatory system in which the insurers select rate assignments that do not reflect the cost of providing the insurance. For example, although an insurer's loss experience might require an indicated rate relativity for a particular zip code for a cost-based rate, insurers commonly select different rate relativities which markedly deviate from the indicated rate relativity.

While the existing regulations do not result in rates that are purely cost-based, the Court in *Spanish Speaking Citizens* concluded that regulations which "preserve a substantial relationship between premiums and the risk of loss ... [are] to be favored over those that would produce arbitrary rates." (*Spanish Speaking Citizens' Foundation v. Low* (2000) 85 Cal.App.4th 1179, 1227.) The proposed regulations, like the existing regulations, do not reflect rates which are in lockstep with a given insurer's loss experience. This situation exists not only because Proposition 103 dictates that some public policy objectives must often override the relationship to the risk of loss, but also because insurers often prefer to select rates which are different from the insurer's loss experience. Nevertheless, the proposed regulations, like the existing regulations, do preserve a substantial relationship between premiums and the risk of loss, and therefore cannot be considered arbitrary or contrary to Insurance Code sections 1861.02(a) and 1861.05.

Similarly, some commentators contend that rating factors which are enhanced or diminished (i.e. – "pumped" or "tempered") to bring the factors into the appropriate weight order are not cost-based and therefore not substantially related to the risk of loss. Under the existing regulations, however, the Department has observed instances of rate

filings in which insurers "pump" the mandatory factor of years driving experience, so that they can increase the influence of zip code on an insured's rate. Indeed, State Farm's comments regarding this rulemaking proceeding recognize that the existing regulations could require pumping or tempering in some cases. Just as the Department recognizes that public policy objectives may take precedence over cost-based rating, the Department recognizes that rates can still be substantially related to the risk of loss despite the fact that some rating factors are pumped or tempered as necessary to bring the rating factors into the correct weight order required by Insurance Code section 1861.02.

Because the proposed regulations ensure that zip code (territory) may be as high as the fourth-most important factor in calculating an insured's premium, rates will still be substantially related to the loss costs associated with a particular region of the state. The Commissioner's proposed regulations achieve the most appropriate balance among the objectives of Proposition 103. Unlike the existing regulations, the proposed regulations ensure that rates will be determined primarily by driving safety record and mileage driven, while still permitting other optional rating factors with a substantial relationship to the risk of loss to have a significant influence on premiums.

1.2: Common Comments:

- The existing regulations produce lower premiums for more good drivers than other alternatives.
- The proposed regulations will raise rates for good drivers in rural regions of the state.
- The proposed regulations will raise rates for low income drivers in rural regions of the state.

Response:

While the Court of Appeal in *Spanish Speaking Citizens v. Low* concluded that the current regulations are lawful, the Court also acknowledged that a method identical to the Commissioner's proposed regulations may also represent a permissible interpretation of Proposition 103. To the extent that the commentator suggests that the current regulatory system produces lower premiums for more good drivers, the Commissioner disagrees, as he has observed substantial evidence to the contrary. Indeed, because the proposed regulations ensure that how you drive will be more important than where you live, it is axiomatic that more good drivers will experience rate decreases under the proposed regulations than under the current regulatory system.

1.3 Common Comments:

- The proposed regulations should be fair for all regions of the state and not just urban regions of the state.
- The Commissioner's proposed regulations ignore the impact upon rural and suburban regions of the state.

Response:

The Commissioner has considered the impact upon both rural and urban drivers in the state. After receiving a petition for rulemaking in May of 2003, the Commissioner personally attended seven informational meetings in regions of the state ranging from Fresno and Chico to Los Angeles and Oakland to discuss the potential impact of the proposed regulations upon rates for urban and rural regions of the state. The Commissioner observed numerous instances – in rural as well as urban locations – where drivers with identical characteristics would pay unjustifiably different premiums simply because they live in the "wrong" zip code.

For example, the Commissioner has observed substantial variations in premium not only for consumers living within just a few miles of each other, but even for neighbors who live in adjoining zip codes. In fact, the differentials in territory relativities between adjacent zip code pairs for some companies do not closely follow the patterns of the industrywide pure premium data. In looking for examples of arbitrary rates and premiums, one need look no further than the premiums established under the existing regulations. Examples such as these demonstrate that the existing regulations are neither purely cost-based nor consistent with Proposition 103's distaste for zip code rating. The Commissioner's proposed regulations will prevent similar disparity between zip codes in the future, by requiring insurers to give more consideration to how you drive rather than where you live. Not only does this approach make sense, it is the approach that the Proposition 103 ballot pamphlet promised to the voters.

1.4 Common Comments:

- According to studies performed by Robert Downer and Mercer Actuarial Consulting, Inc., the proposed regulations will result in an XX% increase for XX drivers. Rates will increase for 52 out of 58 counties.

Response:

At the outset, it is important to point out that any projection of premium that a particular consumer or even a particular region of the state may pay due to the proposed regulations is a matter of substantial speculation. The Commissioner's proposed regulations provide a significant degree of discretion to insurers to decide upon the most prudent manner for implementing the proposed regulations. This discretion exists, in part, because the proposed regulations permit insurers to use any combination of pumping or tempering of rating factors necessary to achieve the order of importance required by section 1861.02(a). Because different insurers will use different rating factors and different methods for achieving compliance with the proposed regulations, it would be virtually impossible to perform a study which would show the precise effect that the proposed regulations will have upon premiums for Californians statewide. Generally speaking, the Commissioner's proposed regulations grant an insurer broad discretion to implement the proposed regulations, so long as a given insurer's rates assign the greatest weight to 1) driving safety record, followed by 2) annual miles driven, followed by 3) years of driving experience, followed by 4) any optional rating factors, weighted individually. While some studies have projected an average rate change for a particular region of the state, the impact of such projection upon a particular consumer will vary significantly due to the unique characteristics of each consumer. Additionally, to date, no study has explored all

of the possible methods by which any given insurer may choose to comply with the proposed regulations. For each of these reasons and others, any comment which suggests that premiums will raise or lower for a particular region of the state by an average of X% is purely speculative and fails to ignore the unique nature of each driver's characteristics as well as the unique manner in which each insurer will choose to comply with the regulations.

This comment includes a figure that suggests a particular County's drivers will receive rate increases of a particular size due to the Commissioner's regulations. To the extent that this comment is referring to the Mercer Actuarial Consulting, Inc. study, the figure appears to have been derived from "Instruction set 3" which was designed to replicate the results of a study performed by Robert Downer. As explained below, the Downer study does not represent an accurate portrayal of the impact of the proposed regulations on Californians' auto rates. Instruction sets 1 and 2, by comparison, showed substantially different and more favorable premium changes for good drivers in all regions of the state.

To the extent that this figure comes from a study produced by Robert Downer, it is important to note that the Downer study produced substantially flawed results which do not represent a reasonable projection of the way in which insurers will comply with the proposed regulations. The Downer study chose to diminish the effect of (i.e. – "temper") any optional factor that was greater than the factor of years of driving experience. At the same time, the Downer study did not permit the possibility of increasing the effect of (i.e. – "pumping") other factors, or a combination of diminishing some factors and increasing others. The proposed regulations, like the existing regulations, permit any insurer to pump or temper any rating factor as necessary in order to achieve compliance. This procedure was not implemented by Mr. Downer's study and directly resulted in the substantial premium shifting projected by Mr. Downer. The Downer study, in short, does not accurately reflect the manner in which insurers will implement the proposed regulations. Because the findings in the Downer study do not accurately reflect the manner in which insurers may implement the proposed regulations, they are irrelevant and consequently have been rejected by the Commissioner.

Mr. Downer's comments regarding the proposed regulations include a new study which he apparently performed in February of 2006. For the reasons described above, this study, like the Mercer data and Mr. Downer's previous study, are constrained by the same limitations and to a reasonable degree of certainty will not reflect the methods of pumping and tempering that individual insurers will use to comply with the proposed regulations.

1.5 Common Comments:

- **Seniors living in rural regions of the state should not be penalized by the proposed regulations.**

Response:

Proposition 103 provides that the number of years of driving experience must be the third most important rating factor, in terms of the weight given to each rating factor. Because

different insurers use differing characteristics to rate drivers according to their age and driving experience, whether a given consumer's age will result in a higher or lower auto insurance rate under the proposed regulations will largely depend upon which insurance company the consumer selects for coverage. Consumers who compare prices before purchasing automobile insurance may find that they will qualify for a lower insurance rate.

1.6 Common Comments:

- **The Downer Study and Instruction Set #3 from the Mercer Study suggest rates in my county will increase by X%.**

Response:

As with many of the figures cited in similar comments submitted to the Department, the figures cited in this comment do not bear a reasonable relationship to the likely rate impact of the proposed regulations. The percentage increase in rates described by this commenter appears to be based upon the results of the Downer study and the related results of Instruction set 3 from the Mercer Study. As explained in Response 1.4 above, the Downer study produced substantially flawed results, because Mr. Downer's analysis simply tempered the weight of the optional rating factors, without allowing for the pumping of mandatory factors. In other words, Mr. Downer's analysis sought to place the burden of the entire shift in a consumer's rate on territory without adjusting other rating factors to affect the rate. The Commissioner's regulations, however, do not condone such an approach. In fact, the Commissioner's regulations envision that insurers will do more than merely temper those factors, such as territory, which are weighted too heavily under Proposition 103. The Commissioner's regulations also seek to force insurers to pump, i.e. - give greater consideration to factors such as years licensed, annual mileage driven and driving safety record – factors that insurers have traditionally placed less emphasis on, when compared to the emphasis placed upon territory.

1.7 Common Comments:

- **The proposed regulations will produce rates which are not actuarially sound.**
- **The proposed regulations, by creating cross-subsidies, violate actuarial standards of practice.**
- **The proposed regulations are unfairly discriminatory or are not substantially related to the risk of loss because they are not actuarially sound.**

Response: As compared to the existing regulations, the Commissioner's proposed regulations represent the lawful interpretation of Proposition 103. Insurance Code section 1861.02 requires that every optional factor, such as territory, be given less weight than driving safety record, annual miles driven or years of driving experience. The American Academy of Actuaries' Statement of Principles for Risk Classification provides that actuarial standards must yield to social acceptability guidelines, including applicable law. (American Academy of Actuaries, Risk Classification Statement of Principles, p. 14, para. H.) Because optional factors must be given less weight than under the proposed

regulations in order to ensure that the mandatory factors are most important as section 1861.02 requires, the resulting rate cannot be considered actuarially unsound on this basis. Moreover, the Commissioner has observed substantial evidence to suggest that rates under the current regulatory system are often not tied to the risk of loss. Indeed, whether territory, gender, marital status or a multiple car discount are entitled to the significant weight they are given by many insurers under the existing regulations is a subject of considerable disagreement within the insurance ratemaking community.

1.8 Common Comments:

- **The proposed regulations violate *Spanish Speaking Citizens' Foundation v. Low*, because they allow for pumping and tempering.**
- **The proposed regulations violate *Spanish Speaking Citizens' Foundation v. Low*, because they create rates which are not based on the cost of providing insurance.**
- **The proposed regulations violate *Spanish Speaking Citizens' Foundation v. Low*, because rates which are not cost-based are arbitrary.**

Response: Although the Court in *Spanish Speaking Citizens* considered the standards of Proposition 103 and concluded that rates which deviated from cost-based pricing would violate Proposition 103's prohibition against arbitrary rates, the Court also conceded that "there may be no one single correct interpretation" of Proposition 103's competing requirements. (*Spanish Speaking Citizens' Foundation v. Low* 85 Cal.App.4th 1179, 1231.) The Court also acknowledged that the existing regulations do not ensure that rates will be determined primarily by driving safety record and mileage driven, as the ballot pamphlet to Proposition 103 intended. (*Spanish Speaking Citizens* 85 Cal.App.4th at 1237-38.) Recognizing the competing goals of Proposition 103, and the fact that rates are not determined primarily by driving safety record and mileage driven, the Court noted that an interpretation of Proposition 103 identical to the interpretation set forth in the Commissioner's proposed regulations, "may be a permissible interpretation of [section 1861.02]." (*Spanish Speaking Citizens* 85 Cal.App.4th at 1239.)

1.9 Common Comments:

- **The proposed regulations do not account for the likelihood of theft in urban areas versus rural areas**
- **The proposed regulations do not account for the likelihood of vandalism claims in urban areas versus rural areas.**

Response:

Claims for vehicle theft or vandalism generally fall under an insurance policy's comprehensive coverage. Claims under that coverage may have limited correlation to the mandatory rating factors. To the extent that comprehensive coverage bears less of a relationship to the mandatory factors of driving safety record, mileage driven and years of driving experience, the Commissioner has revised the regulations to account for the unique concerns raised by comprehensive coverage. Title 10 California Code of Regulations section 2632.8(a) permits an insurer to combine comprehensive coverage

with collision coverage to enhance the proposed regulations' substantial relationship to the risk of loss. The regulatory change which will allow such combination will comply with Proposition 103's weight ordering requirements insofar as comprehensive coverage and collision coverage represent a policy "combination thereof" as described in section 660(a).

Volume 6, Comment No. 1:

Commentator: Kent Keller, on behalf of the American Insurance Assoc., the Assoc. of California Ins. Cos. And the Personal Ins. Federation of California

Date of Comment: March 6, 2006

Type of Comment: Written & Oral

Summary of Comment (pages 1-2): The commentator disagrees with a statement in the Initial Statement of Reasons, which reads: "The Commissioner has determined that the current regulations are not consistent with the stated purposes of Proposition 103 and section 1861.02(a) and therefore must be replaced." *Spanish Speaking Citizens' Foundation v. Low* (2000) 85 Cal.App.4th 1179, 1238 concluded that the existing regulations constitute a "lawful choice among imperfect options." The Court also stated that the existing regulations implemented most of Proposition 103's conflicting demands, and were particularly faithful to the demand that rates must not be arbitrary.

Response to Comment:

The Commissioner is cognizant of the Court of Appeal decision in *Spanish Speaking Citizens' Foundation v. Low*, which held that the existing regulations lawfully implement the competing considerations of Proposition 103 and Insurance Code section 1861.02(a). While the Court in *Spanish Speaking* ultimately concluded that the existing regulations were a lawful choice among imperfect options, the Commissioner believes that the existing regulations are unlawful.

While the Commissioner disagrees with the Court's interpretation of Insurance Code section 1861.02 and Proposition 103 the Commissioner recognizes that the *Spanish Speaking* decision represents the current state of the law, and his response takes into account the Court's interpretation in *Spanish Speaking*.

See response to Common Comment 1.8.

Summary of Comment (pages 2-5): Proposition 103, as interpreted by the Court in *Spanish Speaking Citizens*, does not require that the weights of the individual optional factors must weigh less than any of the mandatory factors. Additionally, the logic of the *Spanish Speaking Citizens* case would dictate that the proposed regulations are unlawful because the proposed regulations will result in arbitrary rates. The rates are arbitrary because the proposed regulations will deflate (i.e.-temper) the optional territory rating factors, despite the fact that the *Spanish Speaking Citizens* case concluded that territory was a more important determinant of the risk of loss than any other factor. The case also

established that neither inflating (i.e.-pumping) nor deflating (i.e.-tempering) a rating factor are a preferred method of adjusting factor weights because the act of pumping or tempering does not coincide with the rating factor's risk of loss.

Response to Comment:

See response to Common Comment 1.8.

Additional Response:

To the extent that this comment suggests that pumping or tempering results in an arbitrary rate and therefore the practice is not permitted under Proposition 103 for purposes of complying with the weight ordering mandate of section 1861.02(a), this comment is simply incorrect. As is explained in Response to Common Comment 1.1, the existing regulations also permit and sometimes require pumping and tempering of rating factors. Indeed, the commentator authored a similar comment for another insurer which admits as much, when he describes the current regulations as permitting the optional and mandatory rating factors to "realize their full weight with no artificial adjustment to the risk of loss, *unless the average weight of the optional factors were to exceed the weight of the third mandatory factor.*" (See comments to RH03029826, Vol. 6, Tab. 5, p. 4, lines 11-16 [emphasis added].) The commentator conveniently fails to explain what happens when the average weight *does* exceed the third mandatory factor. In fact, as explained above, the existing regulations permit and sometimes require insurers to engage in the act of pumping and tempering. The Commissioner has observed instances under the existing regulations where insurers, for example, have pumped years of driving experience because the average weight of the optional factors outweighs years of driving experience. This practice is permitted by the express language of the existing regulations. While the commentator's argument would suggest that the existing regulations are invalid on the grounds that pumping and tempering are not permitted by Proposition 103 and section 1861.02(a), the existing regulations demonstrate that this argument is false and grossly overstates the Court's decision in *Spanish Speaking Citizens*.

Volume 6, Comment No. 2:

Commentator: Steven Weinstein, on behalf of the Farmers Insurance Exchange

Date of Comment: March 6, 2006

Type of Comment: Written

Summary of Comment (pages 1-4, 5-11 & Exhibit A): Proposition 103's stated aim is to prohibit arbitrary rates; that is, rates which do not reflect the cost of providing insurance. The commentator has provided examples of pumping, tempering or performing a 50/50 pump and temper approach to data from the commentator's book of business to demonstrate that the proposed regulations do not result in cost based rating and will adversely impact the commentator's policyholders. The proposed regulations are arbitrary under this standard, not only because the regulations will require insurers to deviate from the cost of providing insurance, but also because data collected concerning

the mandatory factors of driving safety record and annual miles driven suffers from inaccuracy. A study by the Insurance Research Council in 2002 found that many traffic convictions are omitted from Motor Vehicle Reports. Other studies demonstrate that drivers often underreport their annual mileage. The inaccuracies in the data collected by insurers will move rates even further away from the relationship to the risk of loss and cost-based insurance rates. This is prohibited by the *Spanish Speaking Citizens* case and Insurance Code section 1861.02(a).

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.8

Additional Response:

To the extent that this comment suggests that pumping or tempering results in an arbitrary rate and therefore the practice is not permitted under Proposition 103 for purposes of complying with the weight ordering mandate of section 1861.02(a), this comment is simply incorrect. As is explained in Response to Common Comment 1.1, the existing regulations also permit and sometimes require pumping and tempering of rating factors. Indeed, the commentator authored a similar comment for another insurer which admits as much, when he describes the current regulations as permitting the optional and mandatory rating factors to "realize their full weight with no artificial adjustment to the risk of loss, *unless the average weight of the optional factors were to exceed the weight of the third mandatory factor.*" (See comments to RH03029826, Vol. 6, Tab. 5, p. 4, lines 11-16 [emphasis added].) The commentator conveniently fails to explain what happens when the average weight *does* exceed the third mandatory factor. In fact, as explained above, the existing regulations permit and sometimes require insurers to engage in the act of pumping and tempering. The Commissioner has observed instances under the existing regulations where insurers, for example, have pumped years of driving experience because the average weight of the optional factors outweighs years of driving experience. This practice is permitted by the express language of the existing regulations. While the commentator's argument would suggest that the existing regulations are invalid on the grounds that pumping and tempering are not permitted by Proposition 103 and section 1861.02(a), the existing regulations demonstrate that this argument is false and grossly overstates the Court's decision in *Spanish Speaking Citizens*.

Summary of Comment (page 4): The Commissioner's proposed regulations do not meet the authority and consistency standards because the proposed regulations will result in rates which are not based on the risk of loss and therefore are arbitrary and unfairly discriminatory. Rates which are arbitrary and unfairly discriminatory are not consistent with Insurance Code section 1861.02 and Proposition 103.

Response to Comment:

The proposed regulations are within the Commissioner's authority as provided in Insurance Code section 1861.02(e) as well as for the reasons stated in Response to Common Comments 1.1 and 1.8. Moreover, the proposed regulations are consistent and not in conflict with the applicable statutes and are reasonably necessary to effectuate the purpose of the statutes, for the reasons stated in Response to Common Comments 1.1 and 1.8.

Summary of Comment (pages 11-12 & Exhibits B&C): The commentator objects to the characterization of the existing regulations as producing arbitrary rates. The commentator applies the rating characteristics for a female good driver, licensed 22 years who drives 15,000 miles per year with full coverage from the commentator's company. By comparing the driver's rates for both rural and urban ZIP codes and showing the effect of pumping, tempering or performing a 50/50 pump and temper analysis, the commentator concludes that the deviations from cost-based rating are transparent.

Response to Comment:

With respect to the commentator's disagreement with the belief that the existing regulations often produce arbitrary rates, see Response to Common Comments 1.1 and 1.3.

With respect to the argument that the proposed regulations deviate from cost-based rating and are therefore invalid, see Response to Common Comments 1.1 and 1.8.

Summary of Comment (pages 12-15): In the event that the proposed regulations are adopted, the commentator suggests that insurers should be allowed more accurate methods to verify annual mileage. Additionally, the commentator recommends that the number of frequency and severity bands permitted for use should be increased from 10 to 20 bands. Finally, the commentator recommends that the proposed regulations should allow insurers to combine annual mileage with the type of use for the vehicle (commute, pleasure use, etc.). To the extent that an insurer cannot accurately differentiate a driver's annual mileage, they may choose to charge all drivers the same rate. By permitting insurers to correlate the type of use of the vehicle with the annual mileage driven, the commentator suggests that this will avoid "double counting" of the correlation of these factors. The commentator's proposed change would benefit insurers because of the difficulty insurers have verifying mileage driven and help make mileage more closely track cost-based rates.

Response to Comment:

While it may be possible to develop methods for enhancing an insurers' ability to verify annual mileage or other rating factors, such proposals are beyond the scope of this rulemaking proceeding.

Moreover, to the extent that this commentator is concerned about the issue of double counting the correlation between rating factors, the sequential analysis process is

designed to reduce this concern. As Mr. Downer stated in his comments regarding this rulemaking proceeding, “[s]equential analysis...seeks to recognize and eliminate predictive correlation that may exist between various class factors – i.e., reducing double counting.” (See comments of Robert Downer, Vol. 6, Tab 4, page 8, lns. 21-22.) Therefore, the commentator's recommendation to combine annual mileage and type of use of the vehicle is respectfully declined.

While the Commissioner does not believe it would be appropriate to eliminate the zip code rating bands, the Commissioner does agree that the number of bands should be increased in order to minimize the amount of disparity between rates for adjoining zip codes. Thus, while the existing regulations permit up to 100 zip code groupings (10 frequency bands x 10 severity bands), the Commissioner has revised the regulations so that insurers may utilize up to 400 zip code groupings (20 frequency bands x 20 severity bands). This change is reflected in 10 California Code of Regulations section 2632.5(d) (15) & (16) of the revised draft of the proposed regulations.

Summary of Comment (page 15): The proposed regulations should be implemented over a phase-in period. Insurers should be given four months to develop their rates and 3.5 months to account for the process of preparing a rate filing and receiving approval for the filing. Additionally, insurers should be provided with four to eight months to make programming changes to implement the regulations in order to avoid the disruption and magnitude of rate changes.

Response to Comment:

The Commissioner has taken similar insurer input into account and has decided upon a reasonable schedule for implementation which will give insurers flexibility to decide upon the best approach for implementation, but will also ensure that compliance is achieved in a timely manner. Therefore, while the Commissioner believes that four to eight months to develop rates is too much time to implement the proposed regulations, he has revised the regulations to provide for a two-year schedule. This schedule also provides that insurers must bring their rates at least 15% of the way towards full compliance with the proposed regulations in the first class plan filing, but gives insurers discretion to implement the remaining 85%, so long as the implementation is completed by the two-year anniversary of the date the regulations are filed with the Secretary of State. See revisions to 10 Cal. Code of Regulations section 2632.11.

Volume 6, Comment No. 4:

Commentator: Robert Downer, on behalf of the American Insurance Association, the Association of California Insurance Companies and the Personal Insurance Federation of California

Date of Comment: Stamped received on March 6, 2006

Type of Comment: Written

Summary of Comment (pages 1-8 & page 30): These pages provide introductory information about the commentator, applicable actuarial standards and the existing regulations. While these pages also provide a summary of the comments about the proposed regulations, those comments are described in greater detail within the following pages and responded to accordingly.

Response to Comment: Because these pages are not specifically directed at the agency's proposed action or to the procedures followed by the agency in proposing or adopting the action, or are described in greater detail and responded to below, no response is necessary.

Summary of Comment (page 9): By requiring that all optional rating factor weights must weigh less than each of the mandatory factor weights, the proposed regulations will force rates to deviate from the relationship to the underlying risk of loss. This deviation will occur in the form of pumping or tempering of the rating factors so that they will align in the order of importance prescribed by the proposed regulations. Any effort to pump or temper the rating factors, or any combination thereof, will produce premiums that are not based on a change in risk and therefore will be arbitrary, not substantially related to the risk of loss, and actuarially unsound.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.7

See Response to Common Comment 1.8

To the extent that this comment suggests that pumping or tempering results in an arbitrary rate and therefore the practice is not permitted under Proposition 103 for purposes of complying with the weight ordering mandate of section 1861.02(a), this comment is simply incorrect. As is explained in Response to Common Comment 1.1, the existing regulations also permit and sometimes require pumping and tempering of rating factors. Indeed, the commentator authored a similar comment for another insurer which admits as much, when he describes the current regulations as permitting the optional and mandatory rating factors to "realize their full weight with no artificial adjustment to the risk of loss, *unless the average weight of the optional factors were to exceed the weight of the third mandatory factor.*" (See comments to RH03029826, Vol. 6, Tab. 5, p. 4, lines 11-16 [emphasis added].) The commentator conveniently fails to explain what happens when the average weight *does* exceed the third mandatory factor. In fact, as explained above, the existing regulations permit and sometimes require insurers to engage in the act of pumping and tempering. The Commissioner has observed instances under the existing regulations where insurers, for example, have pumped years of driving experience because the average weight of the optional factors outweighs years of driving experience. This practice is permitted by the express language of the existing regulations. While the commentator's argument would suggest that the existing regulations are invalid on the grounds that pumping and tempering are not permitted by Proposition 103 and section

1861.02(a), the existing regulations demonstrate that this argument is false and grossly overstates the Court's decision in *Spanish Speaking Citizens*.

Summary of Comment (pages 9-13 & Attachment A): The proposed regulations appear to focus on the desire to restrict the impact of territory for rating purposes. Where a driver lives and drives, however, is a very important and predictive element of insurance pricing. Factors such as traffic conditions, quality of roads, cost of medical services and prevalence of theft all vary by location. Thus, where one lives is an excellent proxy for these risks and receives substantial weight in the sequential analysis process. The importance of where one lives in determining the risk of loss is supported by a study performed by the Insurance Research Council in 2004 and a study by Progressive Insurance, which concluded that 77% of accidents occur within 15 miles of home.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.9

Summary of Comment (pages 13-25): The commentator performed a study which looked at 41.5% of the insurance marketplace and considered the characteristics of a number of examples from the Department's 2005 California Auto Premium Survey. The study asked insurers to engage in three approaches to complying with the proposed regulations: 1) only perform the act of tempering the optional rating factors until compliance is reached; 2) only perform the act of pumping the mandatory factors until compliance is reached; 3) calculate the average of the weight for years licensed and the most heavily weighted optional factor and then pump and temper factors as necessary to bring the mandatory factors above this average and to bring the optional factors below this average. The results were demonstrated, using real world examples of drivers and the effect of each approach on the driver's rate in different regions of the state. The results of the study found that rates would be unfair because they would create rate subsidies that were not related to the risk of loss. Rate subsidies do not comply with actuarial standards of practice because risk classification is not intended to identify good or bad risks and reward certain groups at the expense of others. The study also found that a driver's insurance premium would be arbitrary, insofar as the differing approaches used all resulted in very different rates for policyholders without any relationship to the risk characteristics. This was particularly true for comprehensive coverage, because the risks covered by comprehensive coverage bear little relationship to the mandatory factors.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.4

See Response to Common Comment 1.9

Summary of Comment (page 26): The proposed regulations have been described as resulting in a revenue neutral change overall, meaning that the same amount of premium will be collected by the insurer, while the allocation of the amount of premium that each individual policyholder will pay to make up that premium will change. This assumption fails to account for the fact that driver groups that receive rate decreases will be influenced to buy more insurance, while persons with rate increases will be influenced to buy less insurance. The result for the insurance company in question and insurers generally will be detrimental to the financial strength and soundness of the automobile insurance market.

Response to Comment:

The proposed regulations will, indeed, reflect a revenue neutral change for a given insurer. The selection of rating factors, ordering of rating factor weights and decisions regarding the relativities to be used within each rating factor do not, by themselves, alter the total amount of premium that an insurer will collect. In fact, the application of rating factors to policyholders is simply the method by which the company decides how much of the total premium collected by the insurer should be allocated to each policyholder. This is the principle of revenue neutrality. To the extent that the commentator believes that policyholders who receive reductions in their rate will seek to purchase greater coverage or vice-versa, the commentator does not rely upon any data for this statement. It appears that the commentator's suggestion is merely speculative at this point. While the Commissioner will continue to carefully observe the automobile insurance marketplace after the proposed changes take effect, he does not expect the proposed regulations to undermine the financial strength of the automobile insurance market.

Summary of Comment (page 26): The proposed regulations will cause more drivers to consider driving uninsured. This will threaten the financial soundness of the automobile insurance market.

Response to Comment:

To the extent that the commentator believes that the proposed regulations will cause more drivers to drive uninsured, the commentator does not rely upon any data for this statement. It appears that the commentator's suggestion is merely speculative at this point. The Commissioner, in fact, anticipates that less drivers will be uninsured in the future, due to the increased availability of automobile insurance required by the good driver requirements of Proposition 103 and the expansion of the Low Cost Automobile program which has increased the availability of affordable insurance for persons who cannot afford it.

Summary of Comment (page 26): Policyholders who receive substantially increased premiums will be given incentive to provide inaccurate rating information, such as an underreporting of mileage driven, in order to avoid paying more for insurance. This will threaten the financial soundness of the automobile insurance market.

Response to Comment:

While it may be possible to develop methods for enhancing an insurers' ability to verify annual mileage or other rating factors, such proposals are beyond the scope of this rulemaking proceeding.

Moreover, the commentator's suggestion that the proposed regulations will create incentives to consumers to provide inaccurate rating information is not based upon any study and appears speculative. Nevertheless, while the Commissioner will continue to carefully observe the automobile insurance marketplace after the proposed changes take effect, he does not expect the proposed regulations to undermine the financial strength of the automobile insurance market.

Summary of Comment (page 27): The proposed regulations will cause competition to diminish over time, because insurers will choose not to invest insurance capital in the California insurance market regions where the proposed regulations would force insurers to expect losses which exceed premiums.

Response to Comment:

Proposition 103 requires insurers to offer automobile insurance to Californians that are good drivers, as defined in Insurance Code section 1861.025. As other commentators have pointed out, roughly 90% of Californians throughout the state qualify as good drivers. By law, insurers cannot refuse to provide insurance to a good driver, irrespective of whether that driver lives in a preferred market region or elsewhere. Thus, the proposed regulations will not diminish competition.

Summary of Comment (page 27-28): The commentator suggests that, to the extent that the proposed regulations seek to lower premiums in urban areas, the Low Cost Automobile Program is an insurance program that is a ready alternative for lower cost automobile insurance.

Response to Comment:

While the proposed regulations may have favorable effects for urban areas, this is not the primary purpose for the proposed regulations. The primary purpose of the proposed regulations is to implement Proposition 103 and Insurance Code section 1861.02 in the way that the Commissioner believes is most consistent with the intent of the voters.

Summary of Comment (page 29): There have been concerns raised during this rulemaking proceeding that rates deviate substantially at ZIP code boundaries. One suggested solution to this problem would be to allow more than 10 bands for the optional rating factors of frequency within a given territory and severity within a given territory. Alternatively, another solution would be to give insurers the option to define rating territories using contiguous zip codes with homogeneous risk, which will mitigate the differences at zip code boundaries.

Response to Comment:

While the Commissioner does not believe it would be appropriate to eliminate the zip code rating bands, the Commissioner does agree that the number of bands should be increased in order to minimize the amount of disparity between rates for adjoining zip codes. Thus, while the existing regulations permit up to 100 zip code groupings (10 frequency bands x 10 severity bands), the Commissioner has revised the regulations so that insurers may utilize up to 400 zip code groupings (20 frequency bands x 20 severity bands). This change is reflected in 10 California Code of Regulations section 2632.5(d) (15) & (16) of the revised draft of the proposed regulations.

Summary of Comment (page 29): The current sequential analysis methods could be fine-tuned to enhance the rating factor weights and relativities by allowing for multi-variate or generalized linear techniques to be used for sequential analysis.

Response to Comment:

The Department's Sequential Analysis Guidelines demonstrate the loss residual and the prior relativities approach that comply with Section 2632.7. The paper also states that "While we are not aware of other methods that meet the requirements of the regulations, if compliance can be demonstrated, another method could be used for performing the sequential analysis." The Department is open to other methods for a sequential analysis but it is incumbent on insurers to bring those methods to the Department's attention and to demonstrate that they comply with the requirements in Section 2632.7.

Volume 6, Comment No. 5:

Commentator: Kent Keller, on behalf of the American Insurance Association, the Association of California Insurance Companies and the Personal Insurance Federation of California

Date of Comment: March 6, 2006

Type of Comment: Written

Summary of Comment (pages 1-4): These pages provide introductory information about the commentator, a description of the relevant background relating to the proposed regulations and a summary of the comments about the proposed regulations.

Response to Comment: Because these pages are not specifically directed at the agency's proposed action or to the procedures followed by the agency in proposing or adopting the Action, or are described in greater detail and responded to below, no response is necessary here.

Summary of Comment (page 4): The Department has provided no evidence of how its proposed regulations effectively harmonize the conflicting demands of Proposition 103 and contain a false assertion that the existing regulations are not consistent with the stated purposes of Proposition 103 and section 1861.02(a).

Response to Comment:

The proposed regulations effectively harmonize the demands of Proposition 103 because, unlike the existing regulations, the proposed regulations ensure that rates will be determined primarily by driving safety record, mileage driven and years of driving experience. At the same time, the proposed regulations still ensure that territory will be given a substantial amount of weight, and will result in rates that remain substantially related to the risk of loss, thereby satisfying the *Spanish Speaking* Court's concern that rates must not be arbitrary. While the *Spanish Speaking* Court stated that pumping or tempering of rating factors was disfavored, it is clear that pumping and tempering is often required under the existing regulations, as well as the proposed regulations. Indeed, contrary to what the *Spanish Speaking* Court appears to have assumed, substantial evidence has demonstrated that rates under the existing regulations often do not correlate to the risk of loss. For a complete assessment of the problems with the existing regulations and the reasons why the proposed regulations harmonize Proposition 103's provisions and are authorized by the Court's opinion in *Spanish Speaking Citizens*, please see the Commissioner's response to Common Comments 1.1, 1.3 and 1.8.

The Commissioner responds to the commentator's assertion that there is a false statement in the Notice of Proposed Action as follows: The Commissioner is cognizant of the Court of Appeal decision in *Spanish Speaking Citizens' Foundation v. Low*, which held that the existing regulations lawfully implement the competing considerations of Proposition 103 and Insurance Code section 1861.02(a). While the Court in *Spanish Speaking* ultimately concluded that the existing regulations were a lawful choice among imperfect options, the Commissioner believes that the existing regulations are unlawful.

While the Commissioner disagrees with the Court's interpretation of Insurance Code section 1861.02 and Proposition 103 the Commissioner recognizes that the *Spanish Speaking* decision represents the current state of the law, and his response takes into account the Court's interpretation in *Spanish Speaking* as indicated in the response above.

Summary of Comment (page 5): The Department took an about face from its stated longstanding position that it was aware of how the proposed regulations would function, because a Department spokesperson indicated at the rulemaking hearing that the Department is uncertain what the effect of the proposed regulations would be on premiums because the method of implementation is unclear. If the Commissioner does not know what the economic impact of his proposed regulations will be on businesses and individuals, the Commissioner's change in position violates Government Code section 11346.3.

Response to Comment:

To the extent that this commentator states that the Department is "uncertain what the effect of the proposed regulations would be on premiums because the method of implementation is unclear", the comment is a mischaracterization of the considerable

steps taken by the Department to consider the economic impact on individuals and businesses in California.

The Commissioner has considered the impact upon both rural and urban drivers in the state. After receiving a petition for rulemaking in May of 2003, the Commissioner personally attended seven informational meetings in regions of the state ranging from Fresno and Chico to Los Angeles and Oakland and invited the public to discuss the potential impact of the proposed regulations upon rates for urban and rural regions of the state. (See Comments to RH03029826 Rulemaking file, Vol. 8, Exhibits 1-7.) The Commissioner observed numerous instances – in rural as well as urban locations – where drivers with identical characteristics would pay unjustifiably different premiums simply because they live in the "wrong" zip code.

The Commissioner pursued further investigation of the effects of the proposed regulations, when he organized a technical workshop and invited members of the insurance industry and consumer groups to discuss the technical aspects of the proposed regulations in May of 2004. At the conclusion of this workshop, the Department's staff prepared detailed sets of instructions for the data that insurers were to submit to Mercer Oliver Wyman Actuarial Consulting, Inc. and invited suggestions from the insurers in attendance to propose alternative instruction sets to provide further examples of how an insurer might properly comply with the proposed regulations. Individual insurers declined the Department's invitation to provide specific results for their companies. As Brandt Stevens of the Department noted, "The Instruction Sets are a compromise, one-size-fits-all analytical device. Insurers felt that an analysis of the best strategy for each company would be too time consuming." (See Comments to RH03029826 Rulemaking file, Vol. 6, Tab. 6, Exhibit 2, p. 2.) While the resulting data does not demonstrate what each particular insurer will do to comply with the proposed regulations, it did provide the Commissioner with sufficient information to make an well-educated projection that insurers would be able to come up with better methods for complying with the proposed regulations than those set forth in instruction sets 1, 2 and 3 from the Mercer data. The Commissioner remains certain that insurers will develop better and unique methods for compliance with the proposed regulations. The Commissioner also continues to recognize that the instruction sets provide a general estimation of the possible effect of the proposed regulations, but clearly do not accurately represent the manner in which individual insurers will comply with the regulations.

The Commissioner went to great lengths to invite insurer and public participation in this rulemaking process. To some extent the Commissioner's efforts were constrained by individual insurers' willingness to participate in the exercise, as explained above. The assessment that the Commissioner ultimately made pursuant to Government Code section 11346.3, however, represents the best possible assessment that could be made, given these limitations.

Summary of Comment (page 6): The Department's own study reveals that 52 of California's counties will have premium increases to subsidize auto insurance rate decreases for 6 urban counties.

Response to Comment:

See Response to Common Comment 1.4

See Response to Common Comment 1.6.

Summary of Comment (page 6): The proposed regulations will lead to arbitrary rates, because any decrease or increase of the weight given to a rating factor through pumping or tempering ignores the true cost of providing insurance.

Response to Comment:

To the extent that this comment suggests that pumping or tempering results in an arbitrary rate and therefore the practice is not permitted under Proposition 103 for purposes of complying with the weight ordering mandate of section 1861.02(a), this comment is simply incorrect. As is explained in Response to Common Comment 1.1, the existing regulations also permit and sometimes require pumping and tempering of rating factors. Indeed, the commentator admits as much, when he describes the current regulations as permitting the optional and mandatory rating factors to "realize their full weight with no artificial adjustment to the risk of loss, *unless the average weight of the optional factors were to exceed the weight of the third mandatory factor.*" (See comments to RH03029826, Vol. 6, Tab. 5, p. 4, lines 11-16 [emphasis added].) The commentator conveniently fails to explain what happens when the average weight *does* exceed the third mandatory factor. In fact, as explained above, the existing regulations permit and sometimes require insurers to engage in the act of pumping and tempering. The Commissioner has observed instances under the existing regulations where insurers, for example, have pumped years of driving experience because the average weight of the optional factors outweighs years of driving experience. This practice is permitted by the express language of the existing regulations. While the commentator's argument would suggest that the existing regulations are invalid on the grounds that pumping and tempering are not permitted by Proposition 103 and section 1861.02(a), the existing regulations demonstrate that this argument is false and grossly overstates the Court's decision in *Spanish Speaking Citizens*.

Additional Response:

See Response to Common Comment 1.1

See Response to Common Comment 1.8

Summary of Comment (page 6-7): Insurers were given about 60 days from the date of the first announcement of the proposed regulations within which to develop data concerning the proposed regulations. This time period is unreasonably short – especially in light of the fact that the operation of the proposed regulations is uncertain.

Response to Comment:

The Commissioner disagrees with this characterization of the extent of time within which the commentator could develop data. The petition for rulemaking for this rulemaking

project began in May of 2003. At that time, the petitioners attached a set of proposed regulations which is similar to the Commissioner's proposed regulations. The commentator has had an opportunity since at least 2003 to develop any data concerning the proposed regulations. Moreover, in May of 2004, the Department of Insurance engaged in a technical workshop and discussed the effect of the proposed regulations with a number of insurance industry members including members of this commentator's organization. Although the Department invited insurers to present additional data regarding the proposed regulations, not a single insurer accepted this offer and the Department consequently limited its analysis to the instruction sets developed by the Department. As Mr. Stevens of the Department explained, "[t]he Instruction Sets are a compromise, one-size-fits-all analytical device. Insurers felt that an analysis of the best strategy for each company would be too time consuming." (See Comments to RH03029826 Rulemaking file, Vol. 6, Tab. 6, Exhibit 2, p. 2.) The commentator has had plenty of time to develop data. In fact, both Robert Downer and another insurer have presented new analyses which were apparently developed between the time that the Department issued its Notice of Proposed Action in December of 2005 and the deadline for written comments in early March 2006. Thus, the suggestion that the commentator was not given sufficient time to develop data is rejected.

Summary of Comment (page 6 &7-11): Robert Downer evaluated the data prepared in 2005 by Mercer, Oliver, Wyman Actuarial Consulting, Inc. as well as a new study performed by Mr. Downer in February of 2006 which reviewed data for 41.5% of the private passenger auto market. The 2006 study considered three alternative methods which would comply with the proposed regulations. The first method, like Mr. Downer's previous study, solely tempered the weight of the optional factors so that each optional factor would weigh less than the third mandatory factor. The second method solely pumped the mandatory factors so that every mandatory factor would weigh more than the optional factors. The third method calculated the average of the weights between the third mandatory factor and the highest weighted optional factor. The average was used as a threshold below which no mandatory factor could fall and above which no optional factor could rise. Rating factors were then pumped and tempered as necessary to achieve these results. Mr. Downer concluded based on the results of the 2006 study that the proposed regulations would be arbitrary, not substantially related to the risk of loss and actuarially unsound, regardless of the method of implementation used by a given insurer. The act of either pumping or tempering results in rates which change for individual drivers for reasons not related to the change in risk for that driver. Thus, the proposed regulations will result in rate subsidies with urban drivers being subsidized by non-urban drivers. High mileage drivers, drivers with less experience and non-good drivers will find that their premiums will increase under the proposed regulations.

Response to Comment:

See Response to Common Comment 1.1
See Response to Common Comment 1.3
See Response to Common Comment 1.4
See Response to Common Comment 1.6

See Response to Common Comment 1.7

See Response to Common Comment 1.8

Summary of Comment (page 10, fn. 5): Driving safety record is predictive of the risk of loss. However, because the definition of good driver under Insurance Code section 1861.025 ensures that over 90% of policyholders will qualify for the good driver discount, insurers cannot use the driving safety record factor in an effective way to correlate premium to the risk of loss. Moreover, the small minority of bad drivers should not be forced to pay premiums which are grossly unrelated to their risk of loss. Increasing the importance of driving safety record as a rating factor will cause this to happen.

Response to Comment:

Many insurers in California employ a superior good driver discount to reflect drivers that have experience that is even better than that which qualifies a driver for the good driver discount. Thus, for example, although the good driver discount looks at a person's driving record over a three-year period, some companies provide a greater discount to persons who have a clean driving record with no accidents or tickets over a five year period. Thus, while the commentator suggests that it is not possible to differentiate between the 90% of policyholders who qualify for the good driver discount, the comment is unfounded and ignores the current rating systems used by many insurers in California. To the extent that a minority of bad drivers will see their rates increase due to the proposed regulations, these rates will be consistent with the intent of the voters that driving safety record must be the single most important factor in determining a driver's rate.

Summary of Comment (page 11-12): Regardless of whether one considers comprehensive coverage, bodily injury coverage or property damage coverage, or whether one considers a particular rating factor, the proposed regulations do not reflect the risk characteristics. The results of pumping and tempering are equally arbitrary, and different combinations of pumping and tempering all result in changes to a driver's rate without changes in risk characteristics for the driver. Efforts to limit or temper the effect of the optional factors of claims frequency and claims severity (the territory factors) arbitrarily distort a very important and predictive element of pricing – the variation in risk based on location.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.8

Additional Response:

To the extent that this comment suggests that pumping or tempering results in an arbitrary rate and therefore the practice is not permitted under Proposition 103 for

purposes of complying with the weight ordering mandate of section 1861.02(a), this comment is simply incorrect. As is explained in Response to Common Comment 1.1, the existing regulations also permit and sometimes require pumping and tempering of rating factors. Indeed, the commentator authored a similar comment for another insurer which admits as much, when he describes the current regulations as permitting the optional and mandatory rating factors to "realize their full weight with no artificial adjustment to the risk of loss, *unless the average weight of the optional factors were to exceed the weight of the third mandatory factor.*" (See comments to RH03029826, Vol. 6, Tab. 5, p. 4, lines 11-16 [emphasis added].) The commentator conveniently fails to explain what happens when the average weight *does* exceed the third mandatory factor. In fact, as explained above, the existing regulations permit and sometimes require insurers to engage in the act of pumping and tempering. The Commissioner has observed instances under the existing regulations where insurers, for example, have pumped years of driving experience because the average weight of the optional factors outweighs years of driving experience. This practice is permitted by the express language of the existing regulations. While the commentator's argument would suggest that the existing regulations are invalid on the grounds that pumping and tempering are not permitted by Proposition 103 and section 1861.02(a), the existing regulations demonstrate that this argument is false and grossly overstates the Court's decision in *Spanish Speaking Citizens*.

Summary of Comment (page 12-13): The 2006 Downer study determined that if an insurer were to use the full temper approach, a few urban areas will receive rate decreases, but the vast majority of cities and rural areas will see rates increase. Moreover, under the full tempering approach, the residents of Santa Barbara County would have their premiums increase by an average of almost 18%. Looking at comprehensive coverage for Santa Barbara County residents, full tempering will result in a 31% rate increase on average for comprehensive coverage.

Response to Comment:

See Response to Common Comment 1.4

See Response to Common Comment 1.9

Summary of Comment (page 13-15): The insurance industry is challenging the proposed regulations, not because companies like the status quo, it is a challenge because the proposed regulations will harm real Californians. Mr. Downer has provided examples of hypothetical policyholders from the Department's Annual Premium Survey, and has applied the full pumping, full tempering and 50/50 pump and temper approaches to the policyholders' premiums. These examples show that premiums would vary widely, depending upon the approach used, and these variations have nothing to do with the risk of loss presented by the hypothetical policyholder. Thus, the rates under the proposed regulations are arbitrary and will violate the law.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.4

See Response to Common Comment 1.6

See Response to Common Comment 1.8

Summary of Comment (page 15-16): The proposed regulations fail the standards of necessity, authority, clarity and consistency; standards which must be met before a proposed regulation may be adopted. The proposed regulations also do not satisfy the requirement that the agency must assess the adverse economic impact. The proposed regulations are not necessary because the current regulations lawfully effectuate the dominant purpose of Proposition 103. Proposition 103 does not provide authority for the proposed regulations. The proposed regulations lack clarity because the regulations would not be easily understood by insurers, given the Department's changing position on the manner in which insurers will implement the proposed regulations. The proposed regulations do not make it possible to assess the adverse economic impact upon policyholders because the Department has stated that it "really has no idea of which insureds benefit and which insureds suffer." The proposed regulations lack consistency because they are in conflict with Proposition 103 and section 1861.02(a) and the Court of Appeal decision in *Spanish Speaking Citizens' Foundation v. Low*

Response to Comment:

To the extent that this comment suggests that the Commissioner has not properly assessed the adverse economic impact of the proposed regulations, the Commissioner's response is reflected in the summary of page 5 of the commentator's comments, above.

Consistency, Necessity & Authority

The proposed regulations are within the Commissioner's authority as provided in Insurance Code section 1861.02(e) as well as for the reasons stated in Response to Common Comments 1.1 and 1.8. Moreover, the proposed regulations are consistent and not in conflict with the applicable statutes and are reasonably necessary to effectuate the purpose of the statutes, for the reasons stated in Response to Common Comments 1.1 and 1.8. Finally, to recap, the proposed regulations are necessary because the Commissioner believes that the existing regulations do not represent the most appropriate interpretation of Proposition 103 and Insurance Code section 1861.02. As explained in Response to Common Comment 1.8, the *Spanish Speaking Citizens* Court acknowledged that the proposed regulations "may be a permissible interpretation of [section 1861.02]". *Spanish Speaking Citizens' Foundation v. Low* 85 Cal.App.4th 1179, 1239.) Moreover, the Court suggested that "there may be no one single correct interpretation" of Proposition 103's weight ordering mandate. *Spanish Speaking Citizens* 85 Cal.App.4th at 1231.)

Clarity

The commentator suggests that the proposed regulations lack clarity because "the Department retreated behind the argument that insurers could implement the regulations in many ways and thus its operation is unknown" and therefore "the regulations would not be easily understood by insurers." Whether the Department has performed a study to show exactly how each insurer will implement the proposed regulations, however, has no bearing upon whether or not the text of the regulations will be easily understood by those

persons directly affected by them. The comment does not suggest that the text of the regulations is not easily understood and therefore does not exhibit a proper objection to the clarity of the regulations. Moreover, the commentator mischaracterizes the nature of the Department's knowledge of the effect of the proposed regulations. A detailed response to this portion of the commentator's remarks is reflected in the response to page 5 of this commentator's comment, above.

Summary of Comment (page 17-21): These pages describe in substantial detail the history of the *Spanish Speaking Citizens' Foundation v. Low* case, the Court's consideration of various issues in that case, and a history of the auto rating factors up to the present proposed regulations.

Response to Comment:

Except as summarized and responded to further below, these comments merely recite the *Spanish Speaking Citizens' Foundation v. Low* case and other historical facts. Because these pages are not specifically directed at the proposed regulations or the procedures followed by the Department in proposing the regulations, the comments require no response.

Summary of Comment (page 17, fn. 10): The trial court in the *Spanish Speaking Citizens* case did not require that all mandatory factors have greater weight than any individual optional factor.

Response to Comment: To the extent that this comment is intended as support for the commentator's conclusion that he proposed regulations are illegal or are contrary to court decisions, this comment bears no relevance on these questions. A trial court decision may not be cited or relied upon as precedent for a legal position. (See, e.g., Cal. Rules of Court Rule 977.) This is particularly true when, as here, the trial court decision has been superseded by a decision of the Court of Appeal.

Summary of Comment (page 19): The most important predictor of the risk of loss is territory. The *Spanish Speaking Citizens* case says "Unrefuted evidence establishes that territory is a more important determinant of the risk of loss than any other single factor." Thus, any auto rating method regulations must deal with this inescapable fact.

Response to Comment:

The proposed regulations do recognize and allow for territory to have a significant effect on rates. For the reasons stated in Response to Common Comment 1.1 and 1.8, however, Proposition 103 and the proposed regulations do not permit territory to outweigh the mandatory factors.

Summary of Comment (page 21): The Commissioner's Initial Statement of Reasons declares that "the current regulations are not consistent with the stated purposes of Proposition 103 and section 1861.02(a) and therefore must be replaced." The proposed regulations, therefore, fail the consistency test of Government Code section 11349

because they are inconsistent with another court decision; namely the *Spanish Speaking Citizens* case.

Response to Comment:

The proposed regulations are consistent because the *Spanish Speaking Court* acknowledged that the Commissioner's proposed regulations may be a permissible interpretation of Proposition 103 and section 1861.02(a). *Spanish Speaking Citizens' Foundation v. Low* 85 Cal.App.4th 1179, 1239.) Moreover, the Court suggested that "there may be no one single correct interpretation" of Proposition 103's weight ordering mandate. *Spanish Speaking Citizens* 85 Cal.App.4th at 1231.) Thus, the proposed regulations are in harmony with and not contradictory to existing law within the meaning of Government Code section 11349(d).

Summary of Comment (page 22-23): The *Spanish Speaking Citizens* case concluded that pumping or tempering of rating factors is not the preferred method for adjusting factor weights and the act of pumping and tempering creates arbitrary results which are unrelated to the risk of loss. The individual method, which is apparently the same method as the proposed regulations, would require some pumping or tempering. The use of such pumping and tempering is inconsistent with the *Spanish Speaking Citizens* court's rejection of that process.

Response to Comment:

To the extent that this comment suggests that pumping or tempering results in an arbitrary rate and therefore the practice is not permitted under Proposition 103 in order to comply with the weight ordering mandate of section 1861.02(a), this comment is simply incorrect. As is explained in Response to Common Comment 1.1, the existing regulations also permit and sometimes require pumping and tempering of rating factors. Indeed, the commentator admits as much, when he describes the current regulations as permitting the optional and mandatory rating factors to "realize their full weight with no artificial adjustment to the risk of loss, *unless the average weight of the optional factors were to exceed the weight of the third mandatory factor.*" (See comments to RH03029826, Vol. 6, Tab. 5, p. 4, lines 11-16 [emphasis added].) The commentator conveniently fails to explain what happens when the average weight *does* exceed the third mandatory factor. In fact, as explained above, the existing regulations permit and sometimes require insurers to engage in the act of pumping and tempering. The Commissioner has observed instances under the existing regulations where insurers, for example, have pumped years of driving experience because the average weight of the optional factors outweighs years of driving experience. This practice is permitted by the express language of the existing regulations. While the commentator's argument would suggest that the existing regulations are invalid on the grounds that pumping and tempering are not permitted by Proposition 103 and section 1861.02(a), the existing regulations demonstrate that this argument is false and grossly overstates the Court's decision in *Spanish Speaking Citizens*.

Summary of Comment (page 23): The Downer data, when coupled with the *Spanish Speaking Citizens* case, leads to the conclusion that the proposed regulations will result in rates which do not reflect the cost of providing insurance. Because section 1861.02(a) and the *Spanish Speaking Citizens* case do not permit arbitrary rates, the proposed regulations should not be adopted.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.4

See Response to Common Comment 1.6

See Response to Common Comment 1.7

See Response to Common Comment 1.8

Volume 6, Comment No. 6:

Commentator: Kent Keller on behalf of 21st Century Insurance Company

Date of Comment: March 6, 2006

Type of Comment: Written

Summary of Comment (pages 1-4): These pages provide introductory information about the commentator, a description of the relevant background relating to the proposed regulations and a summary of the comments about the proposed regulations.

Response to Comment: Because these pages are not specifically directed at the agency's proposed action or to the procedures followed by the agency in proposing or adopting the Action, or are described in greater detail and responded to below, no response is necessary here.

Summary of Comment (4-7 & Exhibits 1&2): The Commissioner's intent behind the proposed regulations, as reflected in the Notice of Proposed Action, Initial Statement of Reasons and a document written by Brandt Stevens is in direct conflict with the Purposes of Proposition 103. While the Commissioner says that driving safety record and miles driven must be more important than the location of the driver's residence according to Proposition 103, the Commissioner does not argue that safety record and miles driven are more important than a driver's residence for determining rates from the perspective of loss costs. Additionally, the Stevens Report's conclusion that while strictly tempering the territory rating factors will cause more premium adjustment, insurers will undoubtedly come up with changes to the class plan that will minimize premium disruption, including methods which combine pumping and tempering to arrive at a less disruptive result is mere speculation and undermines the Commissioner's own arguments in favor of the proposed regulations. According to the Stevens Report, changes to premium which are greater than or less than 7% are *de minimus*.

Each of these statements in the Notice of Proposed Action, the Initial Statement of Reasons and the Stevens Report demonstrate that the Commissioner believes that

significant rate increases suffered by drivers with adverse safety records, high mileage or short experience further the goals of Proposition 103 regardless of whether the loss experience of those drivers justifies the increase. The Commissioner's belief, in this regard, is based upon his assumption that Proposition 103 requires rates to be determined primarily by safety record and miles driven, and that those factors must be more important than the location of the driver's residence. The Commissioner's interpretation of Proposition 103 misinterprets the goals of 103 and ignores the requirement that rates must be substantially related to the risk of loss and must avoid subsidies. Because the proposed regulations are neither consistent with Proposition 103 nor necessary to further the initiative's purpose, they are invalid.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.8

Additional Response:

While the Commissioner does believe that a driver's safety record bears a closer relationship to the risk of loss than where a person lives, what the Commissioner believes is immaterial. Proposition 103 declares that the mandatory factors must be the most important factors for automobile insurance ratemaking. Mr. Stevens' indication that insurers will devise methods for complying with the proposed regulations which bear less premium disruption than the results presented by the Mercer data have been confirmed by the commentator's own method of implementation, as presented in these comments. While any amount of premium shifting is significant to a particular policyholder, the proposed regulations are necessary because the existing regulations do not properly implement Proposition 103's requirement that your rates must be based primarily upon driving safety record and annual miles driven.

Summary of Comment (7-10 & Exhibits B-E of the Lew Declaration):

The commentator has analyzed its own data as well as the results of a study performed by the Insurance Research Council (IRC). The results of the data and study demonstrate that a driver's location is highly correlated with the risk of paying for a loss for that vehicle. The IRC study supports the commentator's use of its own loss cost data and the commentator's assignment of significant weight to territory for purposes of automobile insurance rating. The proposed regulations, however, will require the commentator's company to artificially suppress the importance of territory in a way that does not reflect the company's loss experience. As a result, the proposed regulations will result in rates that are not actuarially sound. Some insureds will pay more than they should, based on loss costs, while some insureds will pay less than they should.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.7

See Response to Common Comment 1.8

Summary of Comment (pages 10-13 & Exhibit F-H of the Lew Declaration): To respond to the comment in the Stevens Report that the proposed regulations would not create severe premium disruption because insurers have an incentive to minimize dislocation, the commentator conducted a study of its own policyholders and the likely effects of the proposed regulations. The commentator's review of the results demonstrates that the proposed regulations will result in significant premium disruption, despite the company's best estimate of how it might mix pumping and tempering techniques to comply with the proposed regulations. The commentator's analysis of its data also shows that 56 out of 58 counties in California will see a rate increase on average, and that some policyholders that are not good drivers will see premium decreases. The data are presented by range of percentage of premium change, percentage premium change by county, and the percentage of premium change by zip code. The commentator has also presented some examples of specific policyholders and the effect of the proposed regulations upon their premium. Based on the commentator's analysis of its data, the commentator anticipates that some individual policyholders will experience anywhere from a 50% increase to a 50% decrease in the premium charged, despite the fact that the policyholders' profiles and driving behavior will remain the same. The commentator concludes that the proposed regulations will create a system of subsidies under which policyholders with lower loss costs must subsidize policyholders with higher loss costs. The changes in premium, contrary to the suggestion in the Stevens Report, will not be minimal. The commentator contends that the resulting rates will be arbitrary.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.8

Additional Response:

While the commentator suggests that some policyholders will receive a premium increase as great as 50%, the Commissioner is confident that there are policyholders within the commentator's book of business that are paying 50% more than they should under the existing regulations as well. Examples of the premium disparity among adjacent zip codes under the existing regulations demonstrates the unfairness of the current system. Policyholders who cannot afford the proposed premium will choose to shop for alternative sources for insurance. Competition and market forces will ensure that policyholders can find a more reasonable rate.

Summary of Comment (pages 13-15& Exhibit I of the Lew Declaration):

By creating a system of subsidies that are not related to loss costs, the proposed regulations will create an inefficient market. The consequence of an inefficient market will be that insurers will not be able to recover their costs for providing insurance for a

particular group, and will decrease an insurer's incentive to provide insurance to that region or group of policyholders. Additionally, policyholders who are forced to pay more for this subsidy may not be able to afford the increase in premium and therefore may be forced to use their savings to make up the difference, decrease their limits of coverage in order to reduce the cost of the premium, relocate to an area where insurance costs are lower, or forego purchasing insurance altogether. The effects of territorial subsidies were studied in Michigan. That study concluded that the effect was to force policyholders to use the residual market for coverage and to reduce the availability of insurance in the regions of the state that were considered to be correlated with a high risk of loss. This concerns the commentator, in part, because the commentator's company offers insurance directly to policyholders throughout the state and may be forced to absorb more business from areas that are of high risk, when compared to insurers who use indirect methods of offering insurance.

Response to Comment:

Proposition 103 requires insurers to offer automobile insurance to Californians that are good drivers, as defined in Insurance Code section 1861.025. As other commentators have pointed out, roughly 90% of Californians throughout the state qualify as good drivers. By law, insurers cannot refuse to provide insurance to a good driver, irrespective of whether that driver lives in a preferred market region or elsewhere. There is no evidence to suggest that Michigan's laws contain consumer protections similar to the good driver provisions or Low Cost Automobile provisions in California. Thus, the proposed regulations will not diminish competition.

To the extent that the commentator believes that the proposed regulations will cause more drivers to drive uninsured, it appears that the commentator's suggestion is merely speculative at this point. The Commissioner, in fact, anticipates that less drivers will be uninsured in the future, due to the increased availability of automobile insurance required by the good driver requirements of Proposition 103 and the expansion of the Low Cost Automobile program which has increased the availability of affordable insurance for persons who cannot afford it.

Summary of Comment (pages 15-16):

The proposed regulations do not meet the standards of necessity and consistency as provided in Government Code section 11349.1. The proposed regulations also violate Government Code section 11342.2, because they are not consistent and are in conflict with the statute and are not reasonably necessary to effectuate the purpose of the statute. The *Spanish Speaking Citizens' Foundation v. Low* case expressly upheld the existing regulations as furthering the purpose of Proposition 103. No evidence exists to suggest that the proposed regulations are necessary to carry out the purposes of Proposition 103. In fact, the proposed regulations are contrary to Proposition 103 because they will result in rates that are not substantially related to the risk of loss.

Response to Comment:

The proposed regulations are consistent and not in conflict with the applicable statutes and are reasonably necessary to effectuate the purpose of the statutes, for the reasons stated in Response to Common Comments 1.1 and 1.8.

Summary of Comment (pages 16-17):

The Commissioner's proposed regulations will be entitled to little or no deference, if they are reviewed by a Court. The *Spanish Speaking Citizens'* case establishes the criteria that the Court uses to determine whether or not it will afford deference to the Commissioner's interpretation of law. The Commissioner's proposed regulations do not meet the standards set forth in the *Spanish Speaking Citizens'* case and therefore the Judiciary will not give the Commissioner's interpretation any deference.

Response to Comment:

Whether or not the proposed regulations will be entitled to deference when presented to a court is a question that is outside the scope of this rulemaking proceeding and does not require a response. To the extent that this comment suggests that the proposed regulations are not consistent with existing law, see the Commissioner's Response to Common Comment 1.8.

Summary of Comment (page 17): Sections 1861.02(a) and 1861.05 are the essential statutes governing automobile insurance rates. The proposed regulations must be consistent with those statutes. Moreover, there must be substantial evidence in the rulemaking file to demonstrate the need for the regulations.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.8

The responses to Common Comments 1.1 and 1.3 make reference to the substantial evidence in the rulemaking file which demonstrates the need for the proposed regulations.

Summary of Comment (page 17-20):

The commentator provides a summary of the opinion of the Court in *Spanish Speaking Citizens' Foundation v. Low*. The summary of the opinion notes, among other things, that the case held that the existing regulations are lawful. The summary also states that the Court sharply criticized a method of implementing Proposition 103 that is very similar to the Commissioner's proposed regulations. Other conclusions reached in the case include a finding that Proposition 103 prohibits arbitrary insurance rates and practices and that rates which do not reflect the cost of providing insurance would be arbitrary. The Court also recognized that a method similar to the Commissioner's proposed regulations would require pumping and tempering in order to bring the rating factors into the proper weight

order, and found that pumping and tempering are contrary to Proposition 103's purposes. With respect to the method of implementing Proposition 103 that is similar to the proposed regulations, the Court also noted that territory could outweigh the mandatory factors because there are two territory factors and therefore the rationale for this approach is untenable. Finally, the Court concluded that a method of implementing Proposition 103 that is very similar to the Commissioner's proposed regulations may be a permissible interpretation, but that evidence was equivocal on that question.

Response to Comment:

On their face, these comments merely recite the *Spanish Speaking Citizens' Foundation v. Low* case and the findings of the Court. Because these pages are not specifically directed at the proposed regulations or the procedures followed by the Department in proposing the regulations, the comments likely require no response.

Nevertheless, to the extent that the summary of the *Spanish Speaking Citizens* case could be read to be implicitly directed at the regulations, the Commissioner responds as follows:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.8

Additional Response:

The commentator's suggestion that the *Spanish Speaking* Court "sharply criticized" a method of complying with the weight ordering mandate which is virtually identical to the method in the proposed regulations, the comment is without merit. Indeed, the *Spanish Speaking* Court suggested that there might be more than one reasonable interpretation of the weight ordering mandate of Proposition 103 and section 1861.02. (*Spanish Speaking Citizens' Foundation v. Low* 85 Cal.App.4th 1179, 1231.) Moreover, the Court noted that an approach which is substantially similar to the proposed regulations might be a permissible interpretation of the weight ordering mandate. (*Spanish Speaking Citizens* 85 Cal.App.4th at 1239.)

Summary of Comment (page 20-23 & Exhibits 3, 4 5 & 6):

While the Commissioner and other commentators have argued that the present regulations are unfair because poor residents are disadvantaged, fairness depends on the eye of the beholder. The relevant standard under Proposition 103 is whether rates are unfairly discriminatory within the meaning of Insurance Code section 1861.05. The Court in *Spanish Speaking Citizens* interpreted "unfairly discriminatory" in a manner that is consistent with nearly 100 years of history in the field of insurance rate regulation. The commentator references Exhibits 3-6 as evidence in support of the commentator's view of the meaning of the term "unfairly discriminatory." That interpretation of unfairly discriminatory refers to rates that do not reflect the cost of providing insurance.

Response to Comment:

On their face, these comments merely recite the commentator's view of the meaning of unfair discrimination within the meaning of Insurance Code section 1861.05. Because these pages are not specifically directed at the proposed regulations or the procedures followed by the Department in proposing the regulations, the comments likely require no response.

Nevertheless, to the extent that the recitation of unfair discrimination and the Commissioner's characterization of the current system as unfair could be interpreted to be directed at the proposed regulations, the Commissioner responds as follows:

See Response to Common Comment 1.1

See Response to Common Comment 1.2

See Response to Common Comment 1.3

See Response to Common Comment 1.7

See Response to Common Comment 1.8

Additional response:

While the proposed regulations may provide some assistance to the urban poor, the primary purpose for drafting the proposed regulations was to bring the automobile rating factors into the correct order of importance described in section 1861.02(a).

Volume 6, Comment No. 6:

Commentator: Declaration of Allen Lew on behalf of 21st Century Insurance Company

Date of Comment: March 6, 2006

Type of Comment: Written

Summary of Comment (page 1-3, paragraphs 1-7 & Exhibit A to the Lew Declaration):

These pages provide introductory information about the commentator, and a description of the relevant background of the commentator's company.

Response to Comment: Because these pages are not specifically directed at the agency's proposed action or to the procedures followed by the agency in proposing or adopting the Action, no response is necessary here.

Summary of Comment (page 2, paragraph 5):

The commentator's company is uniquely subject to regulations affecting automobile insurance in California, due to its concentration in the California automobile insurance business and lack of other lines of business or significant premiums in other states to counteract inaccurate rating. The commentator, therefore, has a substantial need to price its products to accurately reflect the risk of loss posed by each individual policyholder.

Response to Comment:

See Response to Common Comment 1.1

Additional Response:

The proposed regulations will permit an insurer such as the commentator's insurer to price its products accurately to reflect the risk of loss. As explained in Response to Common Comment 1.1, the existing regulations do not reflect the risk of loss in many instances. The Commissioner expects that the proposed regulations will stimulate insurer data collection and risk management by focusing more attention on the rating factors of driving safety record and annual miles driven, rather than territory. The result will be to bring rates into compliance with this objective of Proposition 103. Additionally, as insurers collect additional data to refine rating based on the factors of driving safety and annual mileage, insurers' rates will enhance the relationship to the risk of loss between those factors and the insurers' loss costs.

Summary of Comment (page 2, paragraphs 8-11 & Exhibits B-E to the Lew Declaration): Under the existing regulations, both the optional factors of frequency and severity have a significant weight and great significance. The optional factor of frequency of automobile claims is weighted the highest under the commentator's company's most recent rate filing before the Department of Insurance. The company's loss experience also reflects a great degree of variation, depending upon the location of the vehicle insured. Depending upon the location of a policyholder's vehicle in California the average loss costs can vary by a factor of almost 3 from the lowest to the highest county. This range of loss experience also exists under an analysis by zip codes. These findings are supported by a study performed by the Insurance Research Council, which concluded that California drivers in major cities are more likely to be involved in accidents, file bodily injury claims, and experience automobile losses on a rate that is above the statewide average.

Response to Comment:

See Response to Common Comment 1.1

Additional Response:

The proposed regulations will permit an insurer such as the commentator's insurer to price its products accurately to reflect the risk of loss. As explained in Response to Common Comment 1.1, the existing regulations do not reflect the risk of loss in many instances. The Commissioner expects that the proposed regulations will stimulate insurer data collection and risk management by focusing more attention on the rating factors of driving safety record and annual miles driven, rather than territory. The result will be to bring rates into compliance with this objective of Proposition 103. Additionally, as insurers collect additional data to refine rating based on the factors of driving safety and annual mileage, insurers' rates will enhance the relationship to the risk of loss between those factors and the insurers' loss costs.

Summary of Comment (pages 3-5, paragraphs 12-20, 24 & Exhibits F-H to the Lew Declaration): Rates are actuarially sound when they are produced in accordance with the insurer's anticipated loss costs that are associated with providing insurance. The practice of artificially suppressing a rating factor, such as the optional territory factors, will result in arbitrary rates which are not actuarially sound. In the event the proposed regulations become effective, the commentator intends to pump and temper the rating factors in a manner which will produce the least premium disruption to its policyholders. Exhibits F, G and H are charts which reflect the company's efforts to minimize premium disruption if the regulations take effect. Exhibits F, G and H demonstrate that the premium disruption for the company's policyholders will be severe and arbitrary. The premium disruption sometimes results in rate decreases for cities with loss costs that are higher than the statewide average and premium increases for cities where the loss costs are lower than the statewide average. Examples of the disproportionate effect of the proposed regulations on individual policyholders are also presented.

Response to Comment:

See Response to Common Comment 1.1

See Response to Common Comment 1.3

See Response to Common Comment 1.7

Summary of Comment (pages 6-8, paragraphs 21-23& Exhibit I to the Lew Declaration):

By creating a system of subsidies that are not related to loss costs, the proposed regulations will create an inefficient market. The consequence of an inefficient market will be that insurers will not be able to recover their costs for providing insurance for a particular group, and will decrease an insurer's incentive to provide insurance to that region or group of policyholders. Additionally, policyholders who are forced to pay more for this subsidy may not be able to afford the increase in premium and therefore may be forced to use their savings to make up the difference, decrease their limits of coverage in order to reduce the cost of the premium, relocate to an area where insurance costs are lower, or forego purchasing insurance altogether. The effects of territorial subsidies were studied in Michigan. That study concluded that the effect was to force policyholders to use the residual market for coverage and to reduce the availability of insurance in the regions of the state that were considered to be correlated with a high risk of loss. The proposed regulations, therefore, are likely to reduce insurance capacity in high risk zip codes.

Response to Comment:

Proposition 103 requires insurers to offer automobile insurance to Californians that are good drivers, as defined in Insurance Code section 1861.025. As other commentators have pointed out, roughly 90% of Californians throughout the state qualify as good drivers. By law, insurers cannot refuse to provide insurance to a good driver, irrespective of whether that driver lives in a preferred market region or elsewhere. There is no evidence to suggest that Michigan's laws contain consumer protections similar to the

good driver provisions or Low Cost Automobile provisions in California. Thus, the proposed regulations will not diminish competition.

To the extent that the commentator believes that the proposed regulations will cause more drivers to drive uninsured, it appears that the commentator's suggestion is merely speculative at this point. The Commissioner, in fact, anticipates that less drivers will be uninsured in the future, due to the increased availability of automobile insurance required by the good driver requirements of Proposition 103 and the expansion of the Low Cost Automobile program which has increased the availability of affordable insurance for persons who cannot afford it.